Supreme Court, U.S.
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No. 00-1040

In The

Supreme Court of the United States

SURETY INVESTMENT RECOVERY SERVICES, INC.,

Petitioner,

v.

AMERICAN INSURANCE COMPANY, SEABURY & SMITH, INC., AND NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA.,

Respondents.

On Petition For Writ Of Certiorari To The Washington State Supreme Court

RESPONDENT'S BRIEF IN OPPOSITION

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RESTATEMENT OF QUESTIONS PRESENTED

1. Is it a denial of procedural due process or procedural equal protection for the Washington Courts to enter and affirm summary judgment in accordance with the Washington Rules of Civil Procedure?

2. Is it a denial of procedural due process or procedural equal protection rights for the Washington Courts to reject a claim on the merits based on a written agreement and well-established state law?

CORPORATE DISCLOSURE STATEMENT

The American Insurance Company is a wholly-owned subsidiary of Fireman's Fund Insurance Company, all of whose voting stock is owned by Allianz Insurance Company, a subsidiary of Allianz of America, Inc. Allianz Aktiengesellschaft owns the voting stock of Allianz of America, Inc.

TABLE OF CONTENTS

Page

Restatement of the Case 1

Summary of the Argument 2

Argument 4

A. The Court should deny the Writ because Petitioner has failed to identify any part of the procedure below that was defective, and the Washington Courts gave Petitioner a full and fair opportunity to be heard 4

1. Petitioner's Due Process argument is limited to procedural due process 4

2. Petitioner's Equal Protection argument is limited to procedural equal protection 5

3. Petitioner has failed to identify any defective procedure, and in any event, the Washington Courts gave Petitioner a full and fair opportunity to be heard 6

B. Petitioner has not presented any argument or authority to support a claim for deprivation of its substantive due process or substantive equal protection rights, and accordingly, the Court need not consider any such argument 7

1. Even if the Court were to consider a substantive due process or substantive equal protection claim, the Court should reject it 7

2. The authorities cited by Petitioner on the merits of its claim are distinguishable 14

Conclusion 16

TABLE OF AUTHORITIES

Page

CASES

Armstrong v. Manzo, 380 U.S. 545 (1965) 5

Barbier v. Connolly, 113 U.S. 27 (1885) 5

Baxstrom v. Herold, 383 U.S. 107 (1966) 6

Boddie v. Connecticut, 401 U.S. 371 (1971) 5

Brinkerhoff-Faris Co. v. Hill, 281 U.S. 673 (1930) 5

Carpenter v. Park, 19 Cal. App. 2d 567, 66 P.2d 224 (1937) 15

Chambers v. Baltimore & Ohio R.R., 207 U.S. 142 (1907) 6

Collins v. Harker Heights, 503 U.S. 115 (1992) 8

County of Sacramento v. Lewis, 523 U.S. 833 (1998) 8

Cushman v. National Surety Corporation of New York, 4 Ariz. App. 24, 417 P.2d 537 (1966) 15

Eastin v. Roberts, 19 Cal. App. 2d 567, 66 P.2d 224 (1937) 15

Gulf, Colorado & Santa Fe Ry. v. Ellis, 165 U.S. 150 (1897) 5

Honda Motor Co. v. Oberg, 512 U.S. 415 (1994) 5

Honey v. Davis, 78 Wn. App. 279, 896 P.2d 1303 (1995) 9

In Re Oliver, 333 U.S. 257 (1948) 5

Leuning v. Hill, 79 Wn.2d 396, 486 P.2d 87 (1971) ...11, 15

TABLE OF AUTHORITIES – Continued

Page

Lindsey v. Normet, 405 U.S. 56 (1972) 5

Logan v. Zimmerman Brush Co., 455 U.S. 422 (1982) 4

Municipal Court v. Whaley, 55 A. 750 (R.I. 1903) 14

Richards v. Jefferson County, 517 U.S. 793 (1996) 5

Root v. Moriarty, 39 Ind. 85 (1872) 14

Schmitt v. Insurance Company of North America, 230 Cal. App. 3d, 281 Cal. Rptr. 261 (1991) 15

Seattle First Nat. Bank v. Washington Ins. Guar. Ass'n, 116 Wn.2d 398, 804 P.2d 1263 (1991) 9

OTHER AUTHORITIES

72 C.J.S. *Principal and Surety* § 2 9

72 C.J.S. *Principal and Surety* § 226 14

72 C.J.S. *Principal and Surety* § 239(a) 11

Appleman, Insurance Law and Practice 13

Couch on Insurance 2d (Rev. Ed.) 11

Couch on Insurance 3d 10

Fed. Rule Civ. Proc. 56 1

Restatement of Law 3d, Suretyship and Guaranty 3d (1996) 10, 13

Udelman, *Surety Contractors: Are Sureties Becoming General Liability Insurers*, 22 Ariz. St. L. J. 469 (1990) 15

Washington Rule Civ. Procedure 56 ..... 1, 2, 6

RESTATEMENT OF THE CASE

Petitioner is a corporation formed by the attorney for the Plaintiffs below. He formed this corporation for the purposes of pursuing this claim, based on claims assigned by Plaintiffs to Petitioner. Petitioner's Appendix ("Pet. App.") A 6, 7. Plaintiffs' claims, in turn were assigned to them by Kochcapital. Petition for Writ of Certiorari ("Petition") at p. 3. Thus, the issue is the validity of Kochcapital's claims.

Kochcapital's claims against Respondent The American Insurance Company ("American") are based on bonds issued by American. Each bond names Kochcapital as principal and American as surety. Kochcapital also signed an indemnity agreement, in which it expressly agreed to indemnify American. Clerk's Papers ("CP") 675.

The lawsuit below was initiated by Kochcapital in 1995, and the claim against American was added by a Second Amended Complaint filed January 5, 1996. CP 1. On October 9, 1996, American filed a motion for summary judgment. CP 667.

The Washington rule governing summary judgments, Civ. Rule 56, is similar to Fed. Rule of Civ. Proc. 56. To the extent of any difference, Washington's Rule 56 grants a defending party greater rights than Federal Rule 56. For example, Washington's Rule 56 requires 28 day notice to the opposing party, while the Federal Rule 56 requires only 10 days notice.

Kochcapital had 114 days to prepare for the summary judgment hearing, which is far more than the 28 days

required by Washington's Rule 56. CP 776. During that time Kochcapital filed two written responses to the Motion. CP 676 and CP 748. The first hearing on American's summary judgment occurred on January 31, 1997, but Kochcapital's attorney failed to appear. The summary judgment motion was granted. CP 776.

Kochcapital filed a motion for reconsideration, CP 778, and the trial court considered the merits of the motion at a second hearing on March 7, 1997, at which Kochcapital presented oral argument. The motion for reconsideration was denied, after the court considered and rejected the merits of Kochcapital's claim on the record. Report of Proceedings ("RP") 15.

Kochcapital appealed to the Washington Court of Appeals, which heard oral argument on January 19, 2000. In a unanimous written opinion, the Court of Appeals considered and rejected Kochcapital's appeal on the merits. Pet. App., B-1.

Kochcapital then sought discretionary review by the Supreme Court of Washington, which was denied. This Petition for Writ of Certiorari followed.

SUMMARY OF THE ARGUMENT

Petitioner claims that its procedural due process and procedural equal protection rights were violated by the Washington Courts when they rejected its claim. However, Petitioner fails to identify any part of the procedure below that was defective.

Petitioner was granted two hearings before the trial court that fully considered and rejected the merits of Petitioner's claim. Similarly, the Washington Court of Appeals fully considered and rejected Petitioner's claim on the merits.

Petitioner's true dispute with the Washington Courts is with the merits of their rulings and interpretation of state law, not the procedure. Petitioner's only discussion of the application of law to this specific case is in two footnotes in its Petition: Footnotes 7 and 9. Both these footnotes discuss the merits of Petitioner's claim, and not procedure.

Petitioner has not presented any argument or authority about any deprivation of its substantive due process or substantive equal protection rights. Even if Petitioner had made such an argument, the Court should reject it because nothing in the Constitution or the case law supports creation of a substantive right for a principal to sue its surety on the bonded obligation. The consistent authority and the indemnity agreement signed by Petitioner supports the conclusion of the Washington Courts that no such right exists under these facts.

The Court should deny the Petition.

ARGUMENT

A. The Court should deny the Writ because Petitioner has failed to identify any part of the procedure below that was defective, and the Washington Courts gave Petitioner a full and fair opportunity to be heard.

1. Petitioner's Due Process argument is limited to procedural due process.

Petitioner's argument is that it was denied procedural due process and procedural equal protection by the Washington Courts. While its Statement of Questions Presented refers to due process and equal protection in general, its legal authority is limited to procedural rights.

Petitioner's discussion of its due process claim relies only on procedural due process cases. Petition at pages 13-22. For example, Petitioner cites *Logan v. Zimmerman Brush Co.*, 455 U.S. 422 (1982). However, the plaintiff in that case was challenging the adequacy of the procedure used to consider his claim. The holding in the case affirmed the plaintiff's right to *procedural* due process:

> What the Fourteenth Amendment does require, however, "is 'an opportunity . . . granted at a meaningful time and in a meaningful manner,' Armstrong v. Manzo, 380 U.S. 545, 552 (1965) (emphasis added), 'for [a] hearing appropriate to the nature of the case,' Mullane v. Central Hanover Tr. Co., supra, at 313." Boddie v. Connecticut, 401 U.S., at 378.

Supra, 444 U.S. at 437.

Each of Petitioner's other cited due process cases similarly involve only procedural due process:

Brinkerhoff-Faris Co. v. Hill, 281 U.S. 673 (1930); *Richards v. Jefferson County*, 517 U.S. 793 (1996); *Honda Motor Co. v. Oberg*, 512 U.S. 415 (1994); *In Re Oliver*, 333 U.S. 257 (1948); *Tumey v. Ohio*, 273 U.S. 510 (1927); *Armstrong v. Manzo*, 380 U.S. 545 (1965); *Boddie v. Connecticut*, 401 U.S. 371 (1971).

While Petitioner cites cases dealing only with procedural due process, it does not even suggest that any part of the procedure below was constitutionally defective, as discussed below.

2. Petitioner's Equal Protection argument is limited to procedural equal protection.

Similar to Petitioner's argument on due process, its argument on equal protection is limited to cases dealing with procedural equal protection rights. Petition at pages 22-26.

For example, Petitioner cites *Lindsey v. Normet*, 405 U.S. 56 (1972). However, that case dealt with whether the State denied procedural equal protection by failing to provide appellate review to some claimants, but not others:

> When an appeal is afforded, however, it cannot be granted to some litigants and capriciously or arbitrarily denied to others without violating the Equal Protection Clause

Id. at 77.

Each of Petitioner's other cited equal protection cases also deal with procedural rights: *Barbier v. Connolly*, 113 U.S. 27 (1885); *Gulf, Colorado & Santa Fe Ry. v. Ellis*, 165

U.S. 150 (1897); *Chambers v. Baltimore & Ohio R.R.*, 207 U.S. 142 (1907); *Baxstrom v. Herold*, 383 U.S. 107 (1966).

As discussed below, Petitioner has identified no defective procedure in this case.

3. Petitioner has failed to identify any defective procedure, and in any event, the Washington Courts gave Petitioner a full and fair opportunity to be heard.

As discussed above, the procedure in this case was governed by Rule 56 of the Washington Rules of Civil Procedure, which govern summary judgment motions. As also discussed above, the Washington version of Rule 56 is more favorable to the defending party than the Federal Rule, because Washington requires 28 day notice, and the Federal Rule requires only 10 days. Plainly, Federal Rule 56 meets constitutional muster, so the more generous Washington Rule does also.

Also, Petitioner received not one trial court hearing on its claim, but two. As discussed above in the Restatement of the Case, when Petitioner failed to appear for the scheduled hearing, the Court allowed a second hearing, granting Petitioner a full opportunity to present its case. In any event, Petitioner makes no argument or claim that it was denied any procedural rights by the Washington trial court.

After a full opportunity to be heard before the trial court, Petitioner had another chance to argue its case on appeal. The Washington Court of Appeals considered Petitioner's claim and denied it on the merits. Pet. App.,

B-1. In any event, Petitioner makes no argument or claim that it was denied any procedural rights by the Washington Court of Appeals.

While the Washington Supreme Court refused to consider its appeal, Petitioner cites no authority that the Constitution entitles it to two appeals on its claim.

In sum, Petitioner does not argue that any part of the procedure before the Washington trial court of the Washington Court of Appeals was procedurally defective, and in fact, it was not.

B. Petitioner has not presented any argument or authority to support a claim for deprivation of its substantive due process or substantive equal protection rights, and accordingly, the Court need not consider any such argument.

While Petitioner challenges the merits of decisions by the Washington Courts, *see* Petition, footnotes 7 and 9, it does not contend nor provide any authority that these decisions deprive him of any constitutional rights. Based on that lack of argument and authority, the Court should reject Petitioner's substantive challenge to the Washington Courts' interpretation of state law.

1. Even if the Court were to consider a substantive due process or substantive equal protection claim, the Court should reject it.

As discussed above, Petitioner provides no argument or authority that the Washington Courts' interpretation of

state law violates any federal constitutional right. However, even if the Court were to consider that argument, it should reject it.

This Court has been very reluctant to expand the scope of substantive rights protected by the due process or equal protection clause. *Collins v. Harker Heights*, 503 U.S. 115, 126 (1992) held:

> As a general matter, the Court has always been reluctant to expand the concept of substantive due process, because guideposts for responsible decisionmaking in this unchartered area are scarce and open-ended. *Regents of University of Michigan v. Ewing*, 474 U.S. 214, 225-226 (1985). The doctrine of judicial self-restraint requires us to exercise the utmost care whenever we are asked to break new ground in this field. It is important, therefore, to focus on the allegations in the complaint to determine how petitioner describes the constitutional right at stake and what the city allegedly did to deprive her husband of that right.

Generally, only government conduct that "shocks the conscience" has been held to violate the substantive part of the due process clause. *County of Sacramento v. Lewis* 523 U.S. 833 (1998). Here, no reason exists for the Court to create a new right for a principal to sue its surety on a bonded obligation, nor does the Washington Court's denial of that claim "shock the conscience."

As the Washington Court of Appeals said, Petitioner's only claim against American is the claim assigned to the Appellants by Kochcapital. Pet. App., B-5. Thus, and as Appellants conceded, they "stand in the shoes of KCI [Kochcapital]" in pursuing this claim. CP

681. This means that unless Kochcapital has a right to sue its own surety American, Petitioner's claim must fail and the Washington Court of Appeals properly affirmed the trial court decision.

Petitioner's claim against American is based on surety bonds issued by American on behalf of Kochcapital. CP 677; CP 15-16, Paragraphs 63-65. A surety bond involves three parties, the principal, the obligee (sometimes called the creditor) and the surety:

> Every "suretyship" involves three parties: "principal," whose debt or default is the subject of the transaction; "obligee," one to whom debt or default runs; and "surety," one that undertakes to perform debt or default if the principal does not.

72 C.J.S. *Principal and Surety*, § 2, fn. 7. *See also, Honey v. Davis*, 78 Wn. App. 279, 282, 896 P.2d 1303 (1995), *rev'd on other grounds*, 131 Wn.2d 212, 930 P.2d 908 (1997); *Seattle First Nat. Bank v. Washington Ins. Guar. Ass'n*, 116 Wn.2d 398, 406, 804 P.2d 1263 (1991).

In this case, the surety is American, the principal is Kochcapital, and the obligee is the person named in the bond. The three bonds at issue all refer to Kochcapital as the principal. *See* CP 671-674; Court of Appeals Decision at p. 6, Pet. App. B-6.

Under a surety bond, the surety is secondarily liable for the principal's default to the obligee. The principal is primarily liable. Only if the principal fails to pay the obligee, does the surety have any liability to the obligee.

This is in contrast to an insurance policy, where the insurance company is primarily liable for the loss to the claimant. According to Couch on Insurance 3d § 1:18:

> There is also a difference in the liability of a classic insurer and that of a surety/guarantor. An insurer is the primary party liable upon the occurrence of the contingency, and with the occasional exception as to liability insurance and automobile insurance, must bear the ultimate loss. In the classic case of surety or guaranty, on the other hand, the "insurer" is essentially liable secondarily (regardless of how the liability may be labeled for legal analysis). A surety is ordinarily entitled to indemnity from the principal in case the surety is compelled to perform.

See, also, Decision at p. 7.

The Restatement of Law 3d, Suretyship and Guaranty (1996) ("Restatement 3d"), uses different terminology but reaches the same result. Under the Restatement, the surety is called the secondary obligator, and the principal is called the principal obligator. Restatement 3d, § 1, Reporter Note to Comment d.

According to the Restatement, as between the principal obligor and the secondary obligor, the principal obligor has the duty to perform. Restatement 3d, § 15, Comment a. The secondary obligor can enforce that right:

> Suretyship status gives the secondary obligor recourse against the principal obligor to cause the principal obligor to perform the underlying obligation or bear the cost of performance.

Restatement 3d, § 18(1).

As discussed above, Petitioner's only claim against American is the claim assigned to them by Kochcapital. As they conceded, on that claim they "stand in the shoes of KCI." CP 681. For the reasons discussed below, KCI has no claim against its own surety. Accordingly, Petitioner's assigned claim also has no basis.

Nowhere in the surety bonds does American assume any obligation to its principal, Kochcapital. By the very nature of a suretyship relationship, the principal has obligations to its surety, and not the reverse as claimed by Petitioner. As stated on Couch on Insurance 2d (Rev. Ed.) § 47:234, with respect to a construction surety bond:

> A contractor of course cannot be a claimant on the bond of which he is the principal for the obvious reason that as between him and the surety the contractor's liability is primary and that of the surety is merely secondary: the surety being entitled to indemnity from the contractor to the extent that it is required to make payment on the bond.

A principal has an implied obligation to indemnify its surety for any loss incurred by the surety on the bond. *Leuning v. Hill*, 79 Wn.2d 396, 400, 486 P.2d 87 (1971). As said in 72 C.J.S. *Principal and Surety*, § 239(a):

> In the absence of an express agreement, there is, in a relationship of principal and surety, an implied contract that the principal will indemnify or reimburse the surety for any payment the latter may make to the creditor or any loss he may sustain in compliance with the contract of suretyship, and save the surety harmless.

The Restatement 3d lists the obligations of the principal obligor (Kochcapital) to the secondary obligor (American). These include the obligation to perform the underlying obligation (§ 21), reimburse the secondary obligor (§§ 22-24), and restitution (§ 26).

Beyond these implied obligations, Kochcapital expressly agreed to indemnify American. In the Indemnity Agreement that Kochcapital signed, it agreed:

> This AGREEMENT is made by the Undersigned [Kochcapital] in favor of THE AMERICAN INSURANCE COMPANY, hereinafter referred to as Surety, for the purpose of indemnifying Surety from all loss and expense in connection with any Bonds executed for Kochcapital its subsidiaries; divisions; affiliated companies, as Principal, for which any of the above surety companies now is or hereafter becomes Surety.
>
> In consideration of the execution of any such bonds and as an inducement to such execution by Surety, the Undersigned agrees upon demand to:
>
> 1. Indemnify the Surety and save it harmless from all loss and expense, including attorneys fees, incurred by Surety by reasons of having executed any bond;
>
> * * *

CP 675.

Even before a surety has paid a claim, the principal has a duty to satisfy the underlying obligation and thereby exonerate the surety:

> Upon maturity of a debt, it has been stated that a surety has an equitable right to exoneration and may call upon the principal to discharge it. A surety was stated to be a favorite of equity, which extends its aid in exoneration *quia timet* before it pays, liberally and fully, as against others primarily liable on the debt.

Appleman, Insurance Law and Practice, § 6661. *See also* Restatement 3d, § 21. Besides this implied right of exoneration, American has the express right of exoneration in the indemnity agreement signed by Kochcapital. CP 675.

In sum, by the very nature of a surety bond, a principal cannot make a claim against its surety on a bond issued for that principal's behalf. The only obligation between American and Kochcapital is Kochcapital's express and implied obligation to indemnify and exonerate American. The trial court properly dismissed Petitioner's claim against American.

Petitioner's argument would turn surety law on its ears. It is the principal, Kochcapital, that has a duty to indemnify the surety, American, and not the other way around as Petitioner argues.

The Court should deny the Petition because Petitioner has not provided any argument or authority to support a substantive due process or substantive equal protection claim. Even if it had, the Court should deny the claim based on the indemnity agreement Kochcapital signed and the state law of suretyship.

2. The authorities cited by Petitioner on the merits of its claim are distinguishable.

As discussed above, Petitioner has not provided any argument or authority that the Washington Courts' rulings on the merits of its claim raises any constitutional issues. However, even if it had, none of the cases it cites support its argument that the Court of Appeals decision was contrary to law.

Petitioner cites 72 C.J.S. Principal and Surety § 226, p. 352, to argue that a principal can sue its surety. Petition at 18, footnote 7. What this authority says is:

> The mere fact of suretyship will not be a defense to the surety *if no action has been taken against him on the debt for which he is surety.* [Emphasis added.]

Thus, a principal can sue its surety, but only if the claim is not on the bond. In this case, Petitioner's claim is on the bond, and therefore Petitioner cannot pursue that claim.

The other authorities that Petitioner cites are all distinguishable, because none involve a principal suing a surety for its own default on the bonded obligation.

Root v. Moriarty, 39 Ind. 85 (1872) is distinguishable because it involved a principal suing its surety on a third party's claim, and not the principal's own claim.

Municipal Court v. Whaley, 55 A. 750 (R.I. 1903) is distinguishable because the principal was suing the surety for a default by a co-principal, and not the principal's own default. This Court specifically held "a principal cannot sue his sureties for his own default." *Id.* at 752.

Eastin v. Roberts (cited by Petitioners as *Carpenter v. Park)*, 19 Cal. App. 2d 567, 66 P.2d 224 (1937) is distinguishable because it is not a surety case. It held that an assignor of a promissory note could sue the person that had agreed to indemnify the assignor.

Schmitt v. Insurance Company of North America, 230 Cal. App. 3d, 281 Cal. Rptr. 261 (1991) is distinguishable because the Court in that case rejected the principal's claim against the surety. As the Court of Appeals said in its Decision at p. 7, this case supports the denial of Appellants claim. As quoted by the Court of Appeals:

> "[I]t is not the duty of the surety to protect the principal . . . [t]he surety's duty runs to the third party obligee. . . . "

Supra, Schmitt v. Insurance Co. of North America, 230 Cal. App. 3d 245, 258 (1991).

Petitioner cites an example from the Restatement of Suretyship and Guaranty, which recognizes the duty of the principal to reimburse the surety for a claim paid by the surety. Petition at 12. Petitioner argues that this example supports a duty by the surety to reimburse the principal for a claim paid by the principal. However, as discussed above, the roles of the principal and surety are not the same. It is the principal that has the duty to indemnify the surety, and not the reverse as Petitioner argues. *Leuning v. Hill*, 79 Wn.2d 396, 400, 486 P.2d 87 (1971).

Finally, Petitioner cites an Arizona Law Review article and Arizona case to support its argument. Udelman, *Surety Contractors: Are Sureties Becoming General Liability Insurers*, 22 Ariz. St. L. J. 469 (1990); *Cushman v. National*

Surety Corporation of New York, 4 Ariz. App. 24, 417 P.2d 537 (1966). Petition at 18, footnote 7. However, those authorities deal with bad faith tort claims, and not claims on a bond. Petitioner's claims in this case are on American's bond. Court of Appeals Decision at 2 (Pet. App. B-2); CP 15-16.

In sum, none of the authorities cited by Petitioner support its argument, and none are contrary to the decision of the Washington Court of Appeals.

CONCLUSION

Petitioner argues that its procedural rights under the due process and equal protection clause were violated, but identifies no procedure followed by the Washington Court that was defective.

Petitioner does not argue that its substantive due process or equal protective rights were violated, but if it had, the decisions of the Washington Courts are in accordance with the agreement signed by Petitioner's assignor and the state law of suretyship.

The Court should deny the Petition for Writ of Certiorari.

Respectfully submitted January 22, 2001.

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